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TREASURY FOR OCC/EILEEN SIEGEL
TREASURY ALSO FOR OASIA/ICB/VIMAL ATUKORALA
TREASURY PLEASE PASS TO FEDERAL RESERVE AND SEC/E.JACOBS
JUSTICE FOR DOJ/CRM/ATMLS AND FOR OIA/RICHARD OWENS
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SUBJECT: U.S. Investment Fund Cerberus Buys Austria's Fourth
Largest Bank

REFS: A) 06 VIENNA 1633 B) 06 VIENNA 1270

C) 06 VIENNA 0976

Summary

¶1. The U.S. investment fund Cerberus Capital Management has purchased the BAWAG P.S.K. (BAWAG) bank, Austria's fourth largest banking group, for Euro 3.2 billion (\$4.0 billion). Scandal-ridden BAWAG was up for sale after a government guarantee stabilized a run on the bank in May 2006. The problems followed the disclosure of huge losses from speculative transactions in offshore centers and its involvement in the bankrupt U.S. commodities and futures broker Refco. The Cerberus investment will drive up U.S. FDI in Austria by more than 50% to a new record of approximately Euro 6.5-7.0 billion (\$8.1-8.8 billion). This will solidify the U.S. position as the second largest investor in Austria. The political fall-out from the BAWAG scandal should diminish somewhat, but Parliament's ongoing banking hearings and the criminal investigations of former BAWAG managers will ensure continued media attention. End Summary.

Cerberus Buys Fourth Largest Austrian Bank

¶2. On December 30, 2006, the U.S. investment fund Cerberus Capital Management signed a contract to purchase the BAWAG P.S.K. (BAWAG) bank, Austria's fourth largest banking group, from its former owner, the Austrian Trade Union Federation (OGB). Austrian and EC authorities must still approve the takeover. Cerberus outbid the U.S. investment fund Lone Star and Germany's Bayerische Landesbank. Cerberus reportedly will invest Euro 3.2 billion (\$4.0 billion), consisting of a Euro 2.6 billion (\$3.3 billion) payment to OGB and a Euro 600 million (\$750 million) equity infusion for BAWAG to help offset the Austrian Government's May 2006 Euro 900 million guarantee. The government guarantee was necessary to rescue the bank, after a lawsuit by creditors from the bankrupt U.S. commodities and futures brokerage firm Refco had triggered a run on BAWAG deposit accounts and endangered the bank's stability. In addition to its exposure to the Refco debacle, BAWAG was also reeling from the revelation that it had suffered huge losses from highly speculative transactions through offshore centers in 2001 (reftels). Following BAWAG's out-of-court settlement with Refco creditors in June 2006 (ref A), the OGB moved to sell the bank.

¶3. The OGB's primary criterion was reportedly the amount of the offer, because the OGB desperately wants to cover debts of

approximately Euro 2.5 billion. Cerberus also took Austrian investors on board as minority shareholders. These included a consortium of Austrian industrialists led by former Finance Minister Hannes Androsch, the Austrian subsidiary of the Italian Generali insurance company, the Austrian postal company, and the Wuestenrot home loan savings bank.

Cerberus' Plans for BAWAG

¶4. According to press reports, Cerberus will go public with BAWAG in approximately five years, utilizing the bank as the European headquarters for the activities of General Motors Acceptance Corp. (GMAC). Cerberus recently obtained a majority stake in GMAC. BAWAG reportedly will sell some or all of BAWAG's non-financial sector shareholdings, such as its 36.2% share in the Austrian lottery company or the 43.1% share in ATV, Austria's first nationwide private television network.

Fall-Out on the Austrian Banking and Political Scenes

¶5. The Austrian banking sector has welcomed the BAWAG sale, as it should end depositors' uncertainty and reduce the extended negative media attention surrounding BAWAG in specific and bank regulation in general. With the Cerberus equity injection, the government guarantee for BAWAG will become obsolete at no cost to the Austrian taxpayer. However, criminal investigations of former BAWAG managers and the ongoing parliamentary bank hearings will continue to generate considerable media attention. Parliament constituted the politically charged hearings in October 2006 to investigate the BAWAG scandal and two other banking problems, as well as the supervisory role of the Financial Market Authority (FMA). With the

VIENNA 00000117 002 OF 002

January 11 formation of a Grand Coalition between the Social Democratic Party and the People's Party, there appears to be a will to conduct the hearings on a less partisan basis.

¶6. A casualty of the BAWAG scandal could be the FMA. However, it was unwise investment decisions and, possibly, illegal activity that precipitated the BAWAG scandal not a lack of FMA supervision. Press reports speculate that the Grand Coalition may streamline the separate supervisory functions of the FMA and the Austrian National Bank (ANB) under the ANB's roof.

¶7. The BAWAG debacle has also seriously damaged the image of the once-mighty OGB. The jury is still out as to whether the trade union can institute a successful reorganization to regain credibility and reassert itself on Austria's political landscape.

A Strong Boost for U.S. Investment in Austria

¶8. The Cerberus investment will give a considerable boost to U.S. FDI figures in Austria, which stood at Euro 5.2 billion (\$6.5 billion) at the end of 2004. With a share of more than 11% of total FDI in Austria in 2004, the U.S. was the second largest investor in Austria behind Germany. Investment flows indicate an increase of U.S. FDI in Austria to about Euro 5.6 billion (\$7.0 billion) by the end of 2005, but a steep decline of Euro 1.6 billion (\$2.0 billion) to a total of about Euro 4.0 billion (\$5.0 billion) by mid-2006. The main reason for the large drop was the sale of the Austrian mobile phone operator tele.ring (a subsidiary of Western Wireless) to the German Telekom subsidiary T-Mobile. Even allowing for the minority shareholders' stake in BAWAG (figures on which are not yet available), the Cerberus investment will drive up U.S. FDI by more than 50% to a new record total of about Euro 6.5-7.0 billion (\$8.1-8.8 billion) and should consolidate the number two position of the U.S. among foreign investors in Austria.